

***United States Court of Appeals
for the Second Circuit***



APPELLEE'S BRIEF

77-1342

To be argued by

GARY P. NAFTALIS

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

Docket No. 77-1342 .

UNITED STATES OF AMERICA,

Appellant,

- v -

DOUGLAS P. FIELDS, FREDERICK M. FRIEDMAN,
PETER S. DAVIS, ALAN E. SANDBERG, and
ERIC BERGE,

Defendants-Appellees.

BRIEF FOR DEFENDANT-APPELLEE PETER S. DAVIS

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UNITED STATES COURT OF APPEALS
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UNITED STATES OF AMERICA,

Appellant,

-against-

Docket No. 77-1342

DOUGLAS P. FIELDS, FREDERICK M.
FRIEDMAN, PETER S. DAVIS, ALAN
E. SANDBERG and ERIC BERGE,

Defendants-Appellees.

On Appeal from the United States District
Court for the Southern District of New York

BRIEF FOR DEFENDANT-APPELLEE PETER S. DAVIS

Preliminary Statement

The Government appeals from orders entered in the United States District Court for the Southern District of New York on May 26 and June 3, 1977 by the Honorable Charles S. Haight, Jr., United States District Judge, dismissing Indictment 76 Cr. 1022 as to defendants Davis, Friedman and Sandberg and dismissing parts of said indictment as to defendants Fields and Berge.

The dismissals were ordered pursuant to the District Court's supervisory power over the administration of criminal justice after a factual finding (not challenged by the Government

on this appeal) that staff attorneys of the Securities & Exchange Commission ("SEC") had engaged in a course of deliberate and calculated misconduct. In the alternative, the District Court dismissed counts 1 through 4 for failure to state an offense under the securities laws.

Indictment 76 Cr. 1022 was filed in twelve counts on November 8, 1976. Defendant Peter S. Davis was named only in the first 5 counts. Count 1 charged defendants Fields, Friedman and Davis with a conspiracy to violate the securities laws in connection with the sale of stock in TDA Industries, Inc. ("TDA") in violation of 18 U.S.C. §371. Counts 2, 3 and 4 charged these three defendants with fraud in the offer or sale of TDA stock in violation of 15 U.S.C. §77q(a), with filing a false prospectus for the sale of TDA stock in violation of 18 U.S.C. §1001 and with soliciting proxies from TDA shareholders with false proxy statements in violation of 15 U.S.C. §78n(a). Count 5 charged Fields, Friedman, Davis and Berge with soliciting proxies from shareholders of Westcalind Corp. with false proxy statements in violation of 15 U.S.C. §78n(a). Count 6 charged Friedman and Sandberg with wire fraud in violation of 18 U.S.C. §1343. Counts 7 through 10 charged Friedman and Sandberg with mail fraud in violation of 18 U.S.C. §1341. Count 11 charged only Friedman with soliciting proxies from TDA shareholders with false proxy statements in violation of 15 U.S.C. §78n(a), and Count 12 charged only Berge with making false statements

to the SEC in violation of 18 U.S.C. §1001.

Prior to trial, the defendants moved for dismissal of the indictment. The Court ordered dismissal of those portions that were affected by governmental misconduct. Trial of the remaining charges as to the defendants Fields and Berge have been stayed pending appeal.

Statement of Facts

A. Introduction

After an eleven day hearing, the District Court imposed sanctions under its supervisory power over the administration of criminal justice based upon a finding of governmental misconduct by the New York Regional Office of the SEC. The District Judge specifically concluded that "the SEC representatives. . . engaged upon a deliberate course of concealment", "misleading" and "wrongful" behavior and "calculated and deliberate" non-disclosure (A.57,70,72)*. As the District Court found, the SEC staff knew that the defendants believed that if they consented to an onerous and harsh settlement of an SEC enforcement action, the case would not be referred for criminal prosecution. Armed with that knowledge, the SEC staff nevertheless deliberately misled the defendants and induced them to enter into a far-reaching civil settlement while at the same time covertly referring the case for criminal

*References in form "A" are to the joint appendix; "Tr." refers to the transcript of the evidentiary hearing; and "G.Br." refers to the Government's brief on appeal.

prosecution (A.57-8; 70-72)*. In reaching its decision, the Court below specifically refused to credit the hearing testimony of the principal SEC witnesses on several significant and controverted matters (A.49-50, 52, 68).

Based upon these findings, the Court concluded that those portions of the indictment which were encompassed by the improperly obtained consent decree should be dismissed. The Court reasoned that any lesser remedy was plainly inadequate, particularly in the case of appellee Peter Davis, whose entire law practice and ability to practice law had been destroyed by the SEC's deceptively obtained settlement (A.74-75). On this appeal (unlike the usual criminal appeal) the facts are not to be viewed in the light most favorable to the Government. Rather, the District Judge's findings must be accepted unless shown to be clearly erroneous. Since the Government has not even contended that any of the District Court's findings were clearly erroneous, it is thus bound by the facts as found below. United States v. Ceccolini, 542 F.2d 136 (2d Cir. 1976), cert. granted, U.S., 97 S.Ct. 1693 (1977); United States v. Schipani, 414 F.2d 1262, 1266 (2d Cir. 1969), cert. denied, 397 U.S. 922 (1970). Indeed, the Government has conceded that it does not seek a review of any of the District Court's findings of fact (G.Br.4).

*The Government suggests that the misconduct only consisted of the failure to warn the defendants that a criminal reference had been made before they formally signed the civil settlement. (G.Br. 3, 11). On the contrary, the Court specifically found that there was a pattern of governmental misbehavior which antedated the concealment of the criminal reference (See A. 67, 70, 72).

It follows that the statement of facts for this appeal must be taken from the Court's findings below and not from the Government's brief which often ignores or mischaracterizes the District Judge's conclusions. Thus, for example, the Government's claim about its allegedly strong case against the defendants below was rejected "on the facts" by the District Court (A.58). Simply put, the Government cannot make speculative claims that it would have won and achieved the same extensive relief in the civil and administrative cases even without the settlement and such unsupported claims have no place on this appeal.*

Moreover, the Government's brief seems to be written on the erroneous premise that the defendants have already been found guilty of the offenses charged. In that regard, the Government blithely characterizes as "vicarious admissions" of guilt, statements made by counsel during the SEC settlement discussions. There has, however, been no review of the merits of the Government's allegations by any court and it is elementary that statements made by counsel during the course of settlement discussions would neither be admissible in evidence nor provide a basis for a finding of liability in the civil case, much less

*One may wonder parenthetically why the Government went to such lengths to deceptively secure a settlement of the civil and administrative claims, if its chances of success were so great as it claims here.

of guilt in the criminal case. See Rule 408, Federal Rules of Evidence. If such a portrayal of guilt were to be given any weight on this appeal (as the Government presumably intends it should), it would not only undercut the "clearly erroneous" rule of appellate review but also the presumption of innocence.

B. The Facts As Found By The District Court

In the latter part of 1974 and early 1975, an investigation was being conducted by the New York County District Attorney's Office into certain activities of the defendants Fields, Friedman and Davis. Peter S. Davis was an attorney and senior partner in the firm of Davis, O'Sullivan, Weil & Wolff, who specialized in securities matters. Messrs. Fields, Friedman and Davis were represented by Milton S. Gould, Esq. and former New York State Supreme Court Justice Saul S. Streit of the law firm of Shea, Gould, Climenko & Casey (A.42-43). On January 9, 1975, Gould and Streit were informed by the District Attorney's Office that its investigation had uncovered no violations of New York State law (A.43). Gould, however, believed that the District Attorney would

refer the matter to the SEC and recommended to his clients that they be the first to apprise the SEC of these transactions, a highly desirable procedure in order to "avoid a criminal prosecution." Fields, Friedman and Davis authorized Gould to make certain disclosures to the SEC (A.43-44).

Gould commenced negotiations with the SEC on January 10, 1975, and during the course of those discussions he disclosed the transactions which are the subject matter of the indictment, Count 1, pp. 4-7, ¶¶10(e)(f)(g)(h) and Count 6, pp. 12-13, ¶¶20-21 (A.44-45). The SEC had no prior knowledge of the subject matter of the disclosures made by Gould (A.44). The Court below found that Jeffrey Tucker, the SEC attorney in charge of the investigation, was fully aware that one of Gould's two primary objectives in the negotiations was the avoidance of a criminal reference. Indeed, as far as Peter Davis was concerned this was his only objective. The other objective of counsel was to have Fields and Friedman retained as officers of TDA, an objective that obviously was of no importance to Davis (A.46, 57). Tucker was put on notice as to the objective of avoiding a criminal reference from the initial meeting with defendant's counsel on January 14, and he continued to be fully aware of it throughout the negotiations and settlement with defendants (A.46-47).

As a result of these continuing negotiations, counsel believed that they had an arrangement with the SEC that if a satisfactory settlement could be worked out, the SEC would not refer the case to the United States Attorney for criminal prosecution. Indeed, as the Court found, on at least two occasions,

counsel for the defendants expressly stated to the SEC staff that they understood that there would be no criminal reference of this matter. On both occasions, the SEC staff remained silent in the face of such statements--conduct calculated to mislead and deceive the defendants (A.52, 54-55). Thus, on September 30, 1975, the SEC informed Judge Streit that they would insist on restitution by his three clients in the amount of \$585,000 as part of a settlement--a figure far in excess of any liability that the defendants were thought to have. As the Court found, Judge Streit responded that this was a "horrendous amount. There is a serious question about their liability concerning some of these figures, but in light of the fact that there is to be no criminal prosecution I shall endeavor to obtain the money for you." (A.371) The SEC staff remained silent, causing Judge Streit to believe that such a deal had been struck (A.52).

Moreover, on another occasion, in October, 1975, Stuart Perlmutter, Esq., the other SEC attorney on the case, affirmatively assured Leonard Gordon, Esq., counsel for a prospective director of TDA, that no criminal reference would be made. This false assurance which this District Court found to be "misleading and wrongful" was reported by Mr. Gordon to the defendants (A.53-54, 70).

As a result of such action and inaction by the SEC staff, counsel recommended that Messrs. Fields, Friedman and Davis agree to a harsh settlement of the SEC action. As the Court found, the

defendants resisted the terms that the SEC was demanding for settlement of the civil case. However, their resistance was overcome by the understanding, encouraged by the SEC's deliberate silence, that if a satisfactory settlement was made of the civil action, there would be no criminal reference (A.52).

Concurrently with those events, the SEC staff had been in secret communication with the United States Attorney's Office on the subject of a criminal reference. Stuart Perlmutter informed Assistant United States Attorney Ira Sorkin, Esq. that "we really want to get TDA" but the reference would have to wait until the civil settlement was wrapped up (A.55). On December 1, 1975, the instant case was secretly referred to the United States Attorney for criminal prosecution (A.70).

It was clear from the testimony, and the Court so found that:

"At the time he made the criminal reference of the TDA case, Tucker knew that avoidance of a criminal reference was. . . the only objective for Davis, an attorney who was not an officer (see Finding of Fact 16, supra). Notwithstanding that knowledge, Tucker at no time disclosed to counsel for these defendants that a criminal reference had in fact been made. That non-disclosure was calculated and deliberate, not inadvertent. Tucker testified that he did not want to do anything that would jeopardize the civil settlement (Tr. 1028-1029); and that, in his view, the defendants:'. . . believed that there would be no criminal case growing out of this and that is why they entered into a consent decree.' (Tr.1091)" (A.57-58) (Emphasis added).

The Court found that had defense counsel known that a criminal reference had, in fact, been made, the defendants would not have entered into a settlement of the civil case (A.58). This

was clear from Gould's testimony (which the Court credited):

"Q. Is there any doubt in your mind you had no knowledge whatever, neither you nor anybody in your office as of December 1, 1975 [that the SEC had referred the case to the United States Attorney]?

A. There is no doubt we had no knowledge of that.

Q. If you had such knowledge, would it have made a substantial difference as to how you worked out or at least advised your clients how to work out the disposition of the matter?

A. Yes, sir, there is no doubt in my mind that I would have advised them to terminate the negotiations and have nothing more to do with the SEC people." (A.339)

Unaware of the secret criminal reference, the defendants consented to an onerous and far-reaching civil settlement. In addition to consenting to broad injunctive relief, Fields, Friedman and Davis agreed to pay to TDA a total of \$435,000 as "disgorgement" in connection with the ERD transactions. This was an extraordinary figure because as the Court found "the SEC's own investigation revealed that the total amount received by these defendants from the ERD transactions was only \$72,250.00, and the defendants were still subject to civil lawsuits from the original sellers of the securities involved in the ERD transactions." (A.117)* More importantly Peter Davis also "consented to the most severe administrative sanction available to the SEC, a lifetime resignation from practice before the SEC, as a result of which Davis was forced to

*

The Government's brief repeatedly and inaccurately states that Fields, Friedman and Davis actually received \$435,000 in profits from the ERD transaction. (G.Br. 6, 11, 39, 40, 45, 46). That statement, of course, is contrary to the facts as found and alleged in this case.

resign from the law firm he had built up, which specialized in SEC practice, and was forced to give up the practice of law."

(A.118) In fact, defendant Davis received no benefits from settling the civil case except the avoidance of a trial. As Mr. Tucker conceded:

"Q. Other than avoiding a trial, did [Davis] gain any benefit [from the settlement]?"

A. I don't know of any." (A.623)

C. The District Court's Rulings

The District Court held:

"Silence in the face of Streit's and Ostrow's expressed belief that an agreement in respect of a criminal reference had been reached was misleading, and in the circumstances wrongful. A fortiori, Perlmutter's assurance to Gordon, that no criminal reference would be made, was misleading and wrongful.

* * *

The SEC's strategy of concealment led logically to non-disclosure of the fact that, on December 1, a criminal reference had actually been made. In the circumstances of the case, I conclude that principles of equity and fairness required the SEC representatives to advise defense counsel immediately that a criminal reference had been made. (A.70)

* * *

I conclude, in sum, that the SEC representatives in question engaged upon a deliberate course of concealment, first of their intention to make a criminal reference, and then of the fact that the reference had now been made, in order to obtain civil consent judgments imposing substantial sanctions upon the defendants. A primary objective of Fields and Friedman, and the sole objective of the other defendants, in agreeing to such sanctions was the avoidance of a criminal reference, as the SEC representatives well knew.

In these circumstances, the conduct of the SEC representatives cannot be condoned. It is a sad irony that representatives of a governmental agency dedicated to the prevention of fraudulent and misleading statements fell into this particular pattern of behavior.

* * *

. . . in the circumstances of this case, the SEC's nondisclosure of the present fact of a criminal reference, viewed in the context of all that had gone before, was inequitable and wrong." (A.72) (emphasis in original) (footnotes omitted).

The Court concluded that such conduct made some sanction necessary:

"I conclude without difficulty that a simple admonishment, unaccompanied by any sanction, is inappropriate. One purpose of a sanction in such circumstances is to discourage comparable governmental activity in the future; the Second Circuit in United States v. Jacobs, supra, characterized this as a 'didactic purpose', 547 F.2d at 778. . . ." (A.74)

The Court rejected the Government's suggestion that an appropriate remedy would be a reopening of the civil consent judgment since it would not sufficiently deter such misconduct and would not restore the defendants to the position they previously occupied.

"Furthermore, it is impossible, by reopening the civil consent judgments, to restore the individuals concerned to the positions in which they found themselves at the time of the nondisclosure of the criminal reference, in December of 1975, and the subsequent execution of the consent judgments. That is particularly true in the case of defendant Davis, who as noted resigned from his law partnership and

saw his practice come to a virtual end, as the direct consequence of the SEC's bargained-for withdrawal of Davis from practice before the Commission. The same situation arises, albeit with lesser dramatic force, in respect of the activities which the other defendants were obliged to give up as a result of the consent judgments. I conclude that a reopening of the civil suit is not a sufficient remedy." (A.74-75) See also A.122.

The Court also rejected the remedy suggested by the defendants, i.e. dismissal of all charges and counts of the indictment (A.75). Instead, the Court fashioned a compromise remedy:

"The Court concludes that, in the circumstances of the case, the proper remedy is to strike from the indictment all reference to transactions which were disclosed to the SEC, and were referred to in the civil suit and its subsequent settlement.

* * *

In the light of the facts as found, and in the exercise of the Court's supervisory powers, I exercise my discretion and strike from the indictment those charges and allegations referred to in the civil litigation." (A.76, 82)

ARGUMENT

Point I

The District Court Did Not Abuse Its Discretion By Dismissing Parts Of The Indictment Under Its Supervisory Power

The Government asserts that dismissal was too broad a remedy for the wrongful governmental conduct that occurred. Rather the Government proposes for the first time on this appeal that an alternative remedy be substituted, namely, partial rescission of the civil and administrative settlement which was induced by the

Government's deception. Secondly, the Government speculates that it would have won its civil and administrative cases even without the settlement, so that the remedy of dismissal gave the defendants more than they would have had if they had not been deceived into settling. Thirdly, the Government says that it was the SEC which misbehaved, and that the sanction of dismissal fell on the United States Attorney, who was guiltless. These arguments are without merit since they ignore the function of the supervisory power and the scope of appellate review of the exercise of that power. The issue on appeal is whether the District Court abused its discretion in exercising the supervisory power and not whether some other sanction would have been sufficient to deal with the conceded misconduct of the SEC staff. United States v. Rodman, 519 F.2d 1058 (1st Cir. 1975); United States v. Minnesota Mining & Manufacturing Co., 551 F.2d 1106 (8th Cir. 1977); United States v. Henderson, 525 F.2d 247 (5th Cir. 1975).

A. The Issue Is One Of Supervisory Power, Not Private Civil Remedies

The instant case is not a civil action between private citizens or local governmental units but involves the exercise of the supervisory power against federal official misconduct. The Government's assertion that the remedy is overbroad simply misconceives the issue under the supervisory power and the Government's

reliance on Milliken v. Bradley, 45 U.S.L.W. 4873 (U.S., June 27, 1977) and other school desegregation cases is misplaced. Those cases -- unlike the case at bar -- neither involved federal officials nor an attempt by such wrongdoing officials to use the District Court's processes. The arguments based on Milliken, while of interest to an abstract discussion of equitable remedies for private civil litigation, have no bearing on a case where the parties are before the Court not as private litigants but as federal officials, after official misconduct.

The issue here is not one of equitable remedies but of countenancing "trials which are the outgrowth or fruit of [governmental misconduct] since they 'debase the processes of justice'", United States v. Toscanino, 500 F.2d 267, 276 (2d Cir. 1974). In such instances the supervisory power "may legitimately be used to prevent district courts from themselves becoming 'accomplices in willful disobedience of law.'" [citing McNabb v. United States, 318 U.S. 332, 345 (1943) (Frankfurter, J.)]. Moreover, the supervisory power is not limited to the admission or exclusion of evidence but may be exercised in any manner necessary to remedy abuses of a district court's process." United States v. Toscanino, supra, 500 F.2d at 276.*

*In Toscanino, this Court cited with approval an article by Hogan and Snee on the seminal supervisory power cases, The McNabb-Mallory Rule: Its Rise, Rationale and Rescue, 47 Geo.L.J. 1, 29, 32 (1952), which in turn quoted from Mr. Justice Brandeis dissenting in Olmstead v. United States, 277 U.S. 438 (1928): "If the Government becomes a law-breaker, it breeds contempt for the law" 277 U.S. at 485, and also from Mr. Justice Holmes dissenting in Olmstead: ". . . for my part I think it a less evil that some criminals should escape than that the Government should play an ignoble part." 277 U.S. at 470. These principles, which were affirmed by Mr. Justice Frankfurter in McNabb v. United States, supra, have formed the basis for the Court's supervisory powers.

B. The Supervisory Power Has Been Used To Dismiss Indictments Where There Has Been Official Misconduct

Thus, federal courts have dismissed indictments pursuant to the supervisory power to insure that the proceedings were not tainted with unfairness. In United States v. Rodman, 519 F.2d 1052 (1st Cir. 1975), the SEC representatives had expressly promised the defendant that if he cooperated they would recommend that he not be indicted. The SEC failed to comply with this promise. Although the Government consented to a suppression of any evidence obtained from the defendant, which would eliminate any prejudice to the defendant in the criminal case, the District Court nevertheless dismissed the indictment under its supervisory power (A.164-165). The First Circuit affirmed the District Court's exercise of discretion. Though here the facts giving rise to the exercise of discretion were somewhat different, the same principle of supervisory power is involved. In both Rodman and in the instant case, there was governmental misconduct, which was followed by a prosecution that was the subject of the misconduct, and in both cases the District Court held that the prosecution could not go forward.

In United States v. Jacobs, 547 F.2d 722 (2d Cir. 1976), cert. granted, ___ U.S. ___, 45 U.S.L.W. 3777 (1977), this Court ordered dismissal of an indictment to serve a "didactic purpose" when a strike force attorney failed to warn a potential defendant, testifying before a grand jury, that he was a target of the grand jury's investigation. This omission had deviated from the practice of the United States Attorney in the district and the sanction of dismissal under the supervisory power was deemed necessary to correct the strike force's practices.

The courts' supervisory powers have also been exercised in other Second Circuit cases. See, e.g., United States v. Toscanino, supra, and United States v. Estepa, 471 F.2d 1132 (2d Cir. 1972). In Estepa, the Court of Appeals reversed a conviction and dismissed the indictment after a trial establishing guilt because the grand jury returning the indictment was not told that the evidence it had considered was hearsay. The indictment was dismissed not because it was constitutionally impermissible to present hearsay evidence to a grand jury, but simply to insure that fair procedures were followed.

In United States v. Litton Systems, Inc., Crim.No. 77-70-A (E.D.Va. May 25, 1977), an indictment was dismissed under circumstances similar to but less egregious than those of the instant case. Litton was engaged in a civil controversy with the Government involving millions of dollars and the Government attempted to win an advantage in the civil case (an agreement to permit the Government to reopen and to have new evidence admitted) by bargaining that if this were done a grand jury investigation would be terminated and an indictment would not be sought against Litton. The Government's offer was renewed twice and each time rejected by Litton. The matter was then presented to a grand jury and Litton was indicted.

The Court found that:

"... the government wanted a 'second bite at the apple' in its controversy with Litton over the issue of reimbursement; ... it used the implied threat of indictment in an effort to obtain reconsideration of what Litton, presumptively innocent, was otherwise entitled

to; and. . . when Litton, as was its right, refused to forego that entitlement, namely, the finality of the civil award, the government retaliated -- made good its threat -- by producing an indictment. This is a serious abuse of prosecutorial power." (Opinion, p.5)

The Court held that dismissal pursuant to its supervisory power was appropriate:

"It is entirely possible that upon trial Litton would be found guilty of presenting a false or fraudulent claim; however, when prosecutorial discretion is abused, as here, dismissal of the indictment as a prophylaxis is warranted.

* * *

At the very least the Court is warranted in exercising its supervisory power over federal prosecutors where there is present deliberate and disingenuous conduct." (Opinion, p.9)

In both Litton and the instant case, the Government abused its prosecutorial powers for civil purposes. In both cases, the supervisory power was needed to deter such abuses. The instant case presents an even worse abuse, for the civil advantage was taken, not just threatened, before the prosecution went forward.

It may be noted that the misconduct in Rodman, Jacobs, Estepa, and Litton all resulted in dismissal of the indictment. See also United States v. Minnesota Mining & Manufacturing Co., supra. Thus the Government overstates when it claims that the relief granted in the instant case was "unprecedented."

The Government further argues that a showing of prejudice in the criminal case is necessary before the Court may exercise its supervisory power. The only prejudice that need be shown is

to the administration of justice itself, as the lower court held. In In the Matter of Doe, 410 F.Supp. 1163 (E.D.Mich. 1976), which the Government fails to mention in its brief, defendant offered to surrender a quantity of cocaine in return for a promise that he not be interrogated about its source or the circumstances surrounding its procurement. The Government agreed but then attempted to force him to testify. Defendant's motion to vacate the order was granted:

" . . . [J]udicial integrity and the 'interests of justice' . . . would be offended if the court ratified the government's broken promise to Doe by reaffirming the immunity order. . . .

Neither may the government insist that Doe demonstrate some prejudice before claiming a violation of his rights in the government's broken promise." 410 F.Supp. at 1166.
(See A.77)

See also United States v. Rodman, supra, (no prejudice in the criminal case was found or deemed necessary by either the District Court or the First Circuit); United States v. Litton Systems, Inc., supra.*

C. It Is Irrelevant That This Misconduct Was By SEC Officials Rather Than The United States Attorney's Office

Nor is it a defense that the United States Attorney's Office was not involved in the SEC wrongdoing. If it were the

*The Government's claim that the doctrine of "unclean hands" should preclude the invocation of the Court's supervisory power is frivolous at least as to Doe because the Government specifically conceded below that he had no participation in any manipulative activity charged in the indictment (Tr.1979). And the District Court so found (A.60). Hence, Davis can scarcely be faulted for not disclosing a manipulation in which he played no part.

rule that the United States Attorney's Office had to be involved, the supervisory power would be virtually paralyzed, for official federal misconduct is almost always perpetrated by agents other than the United States Attorney. As the lower court correctly noted: "it is government in all its offices and functions which must be held to standards of fair and honest dealing with the citizens of the Republic." (A.82) See United States v. Rodman, supra, (misconduct by representatives of the SEC); United States v. Orman, 417 F.Supp. 1126 (D.Col. 1976) (misconduct by federal drug enforcement agents); and United States v. Tweel, 550 F.2d 297, 299 (5th Cir. 1977) (misconduct by IRS agent). See also Giglio v. United States, 405 U.S. 150, 154 (1972).

The policies underlying these cases are clear. Unless the Government is held accountable for the conduct of all its officials some will escape judicial scrutiny and official misconduct will go uncorrected. The Courts will become accessories to official misconduct. See Elkins v. United States, 364 U.S. 206, 222 (1960) ("But there is another consideration--the imperative of judicial integrity."); McNabb v. United States, supra, 318 U.S. 332, 345 ("[the] conviction . . . cannot be allowed to stand without making the courts themselves accomplices. . ."); Olmstead v. United States, supra, 277 U.S. at 470 ([N]o distinction can be taken between the Government as prosecutor and the Government as judge. If the existing code does not permit district attorneys

to have a hand in such dirty business it does not permit the judge to allow such iniquities to succeed.") (Mr. Justice Holmes, dissenting).

D. The Appellate Issue Is Abuse Of Discretion, Not Whether There Were Alternative Remedies

The instant case was clearly an appropriate one for the Court to invoke its supervisory power to deter official misconduct. The Government, however, asserts that dismissal of parts of the indictment was not necessary and that a lesser remedy of partial rescission of the civil settlement would have sufficed. In so arguing, the Government ignores the issue presented for appellate review in this case. The issue is not whether this Court would have imposed a different remedy had the SEC's misconduct been before it in the first instance. Rather the issue is whether the District Court acted within its discretion in ordering dismissal of portions of the indictment. The abuse of discretion test has been repeatedly applied in appellate cases reviewing the exercise of the district courts' power to impose sanctions for governmental misconduct.

Thus in United States v. Rodman, supra, the appellate issue before the First Circuit was whether the District Court had acted within its discretion in dismissing the indictment. The First Circuit sustained the District Court's ruling even though the lesser remedy of suppression of inculpatory statements would have eliminated any prejudice to the defendant. ("...the district court's view that the unfairness to the appellee warranted dismissal of the indictment was not an abuse of the court's supervisory function." 519 F.2d at 1059-60).

In United States v. Minnesota Mining & Manufacturing Co., 551 F.2d 1106 (8th Cir. 1977), the District Court dismissed the

indictment on the ground that the Government had breached an agreement not to prosecute. As in the instant case, the Government argued that the lower court imposed an inappropriate remedy and should have imposed an alternate remedy: either allowing defendants to withdraw guilty pleas or ordering suppression of inculpatory evidence. The Court of Appeals for the Eighth Circuit declined to make a de novo decision as to the appropriate remedy:

"The remedy for the breach of this promise rests in the discretion of the trial court, see Santobello v. New York, 404 U.S. 275, 263, 92 S.Ct. 495, 30 L.Ed. 427 (1971), and under the circumstances of this case we cannot say that the remedy of dismissing the indictment was either undue or an abuse of discretion." (551 F.2d at 1112.)

See also United States v. Henderson, 525 F.2d 247 (5th Cir. 1975) (Dismissal of indictment as sanction against Government's unfair conduct not an abuse of discretion); Santobello v. United States, 404 U.S. 257, 263 (1971) ("The ultimate relief to which petitioner is entitled we leave to the discretion of the state court, which is in a better position to decide. . .").

The policy reasons for allowing discretion to the District Court are several. As an institution, district courts live close to the agencies involved and deal with them on a regularly recurring basis. They see the witnesses at hearings on official misconduct and can develop a sensitive basis for determining what sanctions are needed. In many cases, including this one, detailed evidence is required in order to assess alternative dispositions.

Here, for example, the District Court took evidence on the consequences of reversing the civil settlement, which it viewed as one option, and of reversing the administrative settlement which had involved Davis' resignation from the SEC Bar. The issues are best handled within the discretion of the District Court, subject to appellate review for abuse of discretion.

E. The District Court Did Not Abuse Its Discretion

Here there was no abuse of discretion. That the District Court chose to dismiss parts of this indictment rather than to reverse the civil settlement was a decision well within the Court's discretion and the boundaries of prior decisions. It was properly made by the judge who had seen the wrongdoing officials on the stand and who had been able to examine the problems within the agency, after hearing testimony, not only from agency officials at fault but also from the heads of the Enforcement Division and the New York Regional Office. It was made, moreover, after a careful and considered examination of alternative solutions. Thus, the District Court found that reversal of the civil settlement was unpalatable because it would deprive possibly wronged parties of restitution and would not adequately deter future governmental misconduct. The District Court also reasoned that such a remedy simply would not restore to Davis all that had been improperly taken away. As part of the SEC settlement, Davis resigned for life from practicing law before the SEC and as "a direct consequence" resigned from the law firm he had founded and was forced to give up the practice of law. In fact, Mr. Davis, who in 1975 was acknowledged to be one of the bright up and coming young SEC lawyers in New York

does not presently have any regular employment (A.74-75, 118, 523, 527-29, 619-21). Obviously, as the District Court found, setting aside the civil settlement cannot restore to Davis the law practice he lost. His old firm cannot be directed to take him back as senior partner. Lost clients cannot be compelled to once again retain Mr. Davis as their counsel. Mr. Davis' reputation cannot be restored by court order. As SEC Commissioner A. A. Sommer, Jr. aptly stated:

"All of us know of the dramatic and unfortunate impact any litigation questioning the conduct of a professional can have on his career, as well as his finances. Corporations can withstand legal attacks and go forward to thrive and not infrequently corporate executives can do the same. However, it is far more difficult for a professional to retain his community standing, his self-respect and his financial security after questions have been raised publicly concerning his integrity or his competence." (A. A. Sommer, Jr., The Emerging Responsibilities of the Securities Lawyer, January 24, 1974, at 13) (emphasis supplied).

Quite plainly, it was reasonable for the District Court to conclude that the harm that Davis suffered as a direct result of the wrongful governmental conduct dictated that a sufficient sanction be imposed. The District Court plainly acted within its discretion in concluding at least as to Davis that dismissal was the proper remedy.

In exercising its discretion the District Court was not obliged to credit the SEC's speculative claim that the agency would have prevailed civilly and administratively even if it had not behaved improperly. Indeed, the District Court specifically

declined to render such a finding after hearing the testimony of the SEC staff (A.58), and no claim is here made that this determination was clearly erroneous. Common sense says, moreover, that official misconduct cannot be excused because the agency subsequently concludes that the misconduct was unnecessary. Nor can any settlement be viewed in the light most favorable to the party which obtained it by fraud.*

Particularly inappropriate is the repeated claim in the Government's brief that it was "a foregone conclusion" that Davis would have had to give up his right to practice before the SEC for the rest of his life. The Court refused to make such a finding, although the Government urged that position below. Moreover, this assertion is based solely on the testimony of one SEC staff attorney (A.564) whose testimony on a number of other important and controverted matters was rejected by the District Judge (A.49-50, 52, 68).

Even if the SEC had had a case for liability there is no evidence that it would have obtained the same extensive ancillary relief that it obtained by settlement, or even that it would have been able to demonstrate a likely resumption of illegal activity to support the issuance of an injunction. See the test in SEC v. Bangor Punta Corp., 331 F.Supp. 1154 (S.D.N.Y. 1971), aff'd sub. nom., Chris-Craft Industries, Inc. v. Piper

*That the SEC staff felt it necessary to engage in substantial improprieties in order to gain its settlement casts doubt on the Government's recent claim that the result would have happened anyway.

Aircraft Corp., 480 F.2d 341 (2d Cir.), cert. denied, 414 U.S. 924 (1973); and SEC v. Bausch & Lomb, Inc., 420 F.Supp. 1226 (S.D.N.Y. 1976), affirmed, CCH Fed. Sec. L. Rep. ¶96, 186 (2d Cir. September 30, 1977). Indeed, proving such a likelihood of reoccurrence would have been particularly difficult in Mr. Davis' case. Prior to the transactions in issue, Mr. Davis had led a blameless life and had never been accused of any wrongdoing. Four and a half years had passed since the allegedly illicit events and there has been no claim of reoccurrence -- an important factor militating against the granting of injunctive relief. SEC v. Universal Major Industries, 546 F.2d 1044, 1048 (2d Cir. 1976); SEC v. National Student Marketing Corp., 360 F.Supp. 284, 297 (D.D.C. 1973); SEC v. Harwyn Industries Corp., 326 F.Supp. 943, 957 (S.D.N.Y. 1971); SEC v. Texas Gulf Sulphur Co., 312 F.Supp. 77, 89-90 (S.D.N.Y. 1970), aff'd, 446 F.2d 1301 (2d Cir.), cert. denied, 404 U.S. 1005 (1971).

Moreover, since the civil settlement was the result of the Government's misconduct, the lower court quite properly held that the Government was estopped from arguing that the settlement was inevitable. United States v. Alessi, 536 F.2d 978 (2d Cir. 1976); United States v. Baird, 414 F.2d 700, 707 (2d Cir. 1969), cert. denied, 396 U.S. 1005 (1970); United States v. Gross, 451 F.2d 1355, 1358 (7th Cir. 1971); United States v. Georgia-

Pacific Co., 421 F.2d 92, 103 (9th Cir. 1970).*

As to the remedy of partial rescission, raised here but not below, all of the same points hold, as well as others. The District Court had no obligation to consider such a proposal, not presented by the Government below, which not only failed to meet the objections to total civil rescission, but would add a further element of injustice by causing the defendants to suffer further loss. Indeed, it can hardly be claimed that the District Court abused its discretion by not invoking this remedy since it had never been brought to its attention in the first place. It is curious to know why such a proposal is advanced here, unless it is intended by its extreme nature to make somewhat more palatable the possibility of complete civil rescission -- the position the Government unsuccessfully urged below.

In short, the remedy of dismissing the indictment, which had been applied in numerous criminal cases under the supervisory power, was reasonable and well within the District Court's discretion.

*The Government seeks to negate the District Court's finding that the civil settlement was not inevitable by characterizing the ruling as "incomprehensible," because it estopped the SEC from making the contention rather than the United States Attorney. But it is clear from finding 37 (A.58-59) that the Court is referring to the testimony of the SEC attorney who contended that the settlement was inevitable. The Court held that that attorney and thereby the SEC should be estopped from making such an assertion since the argument was only available as a result of the SEC's misconduct. Obviously, the Government-Appellant herein should be equally estopped. See Giglio v. United States, supra, 405 U.S. at 154.

Point II

The Dismissal of Count 4 Should
Be Affirmed Because There Is No
Transactional Causation

Count 4 of the indictment charges a violation of the proxy rules because of a failure to disclose the allegedly fraudulent and manipulative transactions that are outlined in Count 1. None of these transactions related to the matters on which the shareholders were being asked to vote. The District Court dismissed:

"because there is no causal connection between either of the acts scheduled for the TDA stockholders' meeting (amendment of the stock option plan and election of directors) and the various acts and transactions alleged in count one of the indictment." (A.90)

The Court, in following Judge Owen's recent decision in Levy v. Johnson, '76-'77 CCH Fed. Sec. L. Rptr. ¶95,899 (S.D.N.Y. February 15, 1977) held that the acts alleged in Count 1 had been accomplished prior to the stockholders' meeting referred to in the proxy statement and that they, therefore, did not bear "any direct relationship to the business sought to be accomplished at the meeting and referred to in the proxy statement." (A.91-92) In the absence of such a relationship, termed by the courts as "transactional causation", the Court was required to dismiss.

The policy underlying this requirement has been enunciated in decisions of the Supreme Court. Thus, in J.I. Case Co. v. Borak, 377 U.S. 426, 431 (1964) the Court held:

"The purpose of §14(a) is to prevent management or others from obtaining authorization for corporate action by

means of deceptive or inadequate disclosure in proxy solicitation."
(Emphasis added)

In Mills v. Electric Auto-Lite Co., 396 U.S. 375, 381 (1970), the Court quoted the relevant legislative history of Section 14(a) (H.R. Rep. No. 1383, 73d Cong., 2d Sess., 14; S. Rep. No. 792, 73d Cong., 2d Sess., 12) and concluded that the proxy statute:

"[W]as intended to promote 'the free exercise of the voting rights of stockholders' by ensuring that proxies would be solicited with 'explanation to the stockholder of the real nature of the questions for which authority to cast his vote is sought'." (Emphasis added)

See also T.S.C. Industries, Inc. v. Northway, Inc., 426 U.S. 438 (1976).

The Second Circuit approved the same policy considerations in interpreting the scope of the proxy rules. In Schlick v. Penn-Dixie Cement Corp., 507 F.2d 374, 381, 383 (2d Cir. 1974) cert. denied, 421 U.S. 976 (1975), the Court stated:

"[W]e must immediately confront the issue whether the proxy violations themselves caused the transaction in question, the exchange. Both types of causation must be shown in order to state a Section 14(a) claim: transaction causation to show a violation of the law from which an appellant may recover, and loss causation to show damages.

* * *

Causation is a concept stemming from the law of torts, but we are here talking

about the statutory purpose of the proxy rules, a purpose which as Mills itself pointed out, arises from Congressional belief in 'fair corporate suffrage to obtain which 'explanation to the stockholder of the real nature of the questions for which authority to cast his vote is sought.'**

In the case at bar the transactions not disclosed in the proxy were the alleged defrauding of ERD shareholders who sold TDA stock in April and May, 1971 (paragraphs 10(f) through 10(h) of Count 1)**, the payment in March 1971 by Bernardi Resources, Corp. to two defendants other than defendant Davis, of moneys allegedly paid to Bernardi by a TDA subsidiary (paragraph 10(e) of Count 1) and market manipulation by the defendant Fields in November, 1971 (paragraphs 10(a) through 10(c) of Count 1).*** Those acts were completed at the time the

*Although the above-cited cases were civil and not criminal cases, the Supreme Court has emphasized that under the securities laws the primary difference between civil and criminal lawsuits is the burden of proof required for a verdict. That is, in a criminal case the stricter requirement of satisfying the jury beyond a reasonable doubt is applicable. However, the interpretations of the securities laws in the civil cases are equally applicable to this criminal action. SEC v. C.M. Joiner Leasing Corp., 320 U.S. 344, 355 (1943); United States v. Charney, 537 F.2d 341, 348 (9th Cir.), cert. denied, 97 S.Ct. 528 (1976). Hence, if the proxy rules are not violated in a civil case, then a fortiori, there is no criminal violation.

**The Government, for the first time on this appeal, contends that these transactions also constitute a short-swing trade within the meaning of Section 16(b) of the Securities Exchange Act (15 U.S.C. §78p(b)). Regardless of whether the Government labels the transaction securities fraud or short-swing trade, the proxy did not cause the transactions. See discussion infra, at pp. 34-36.

***The Government conceded below that Mr. Davis neither participated in nor knew about the November market manipulation. There is no allegation that he participated in or knew of the Bernardi transaction (A.60).

proxy statement was issued and were in no way furthered by the proxy statement. The proxy statements in no way sought approval or ratification of those past transactions by the shareholders. Indeed, the ones who allegedly were defrauded in April and May were no longer shareholders by December, when the proxy statement was issued. The November transactions involved purchasers of stock who were allegedly defrauded and not shareholders at the time. Thus, they would not have received the proxy statement. In short, the defendants' action could not have been furthered by the proxy statement.

Recently Judge Pierce in Lewis v. Elam, CCH Fed. Sec. L. Rptr. ¶ 96,013 (S.D.N.Y. April 5, 1977) held that it was necessary to prove "that the proxy violations themselves caused the transaction in question." (at 91,555) In Lewis, the question was whether the proxy vote caused the directors to make improper foreign bribes and domestic campaign contributions. Judge Pierce held that the proxy vote did not cause the directors to so act because the "proxy solicitation was not a link in the accomplishment of the alleged improper payments." (Id.) This is just as true in the case at bar where the proxy solicitations in no way furthered the alleged misconduct by the defendants, which the Government concedes occurred before the proxy statement was distributed. In short, the proxy solicitation was "not a link" in the accomplishment of that alleged scheme; it had nothing at all to do with it.

See also Weiss v. Sunasco, Inc., 316 F.Supp. 1197, 1205 (ED Pa. 1970); Robbins v. Banner Industries, Inc., 285 F.Supp. 758 (S.D.N.Y. 1966); Barnett v. Anaconda Co., 238 F.Supp. 766 (S.D.N.Y. 1975); Epic Enterprises, Inc. v. Brothers, 395 F.Supp. 773 (N.D. Okla. 1975); Walner v. Friedman, 410 F.Supp. 29 (S.D.N.Y. 1975).

In a decision predating that of Levy v. Johnson, Judge Owens had held that a proxy statement was misleading because it did not reveal that a nominee for election as a director had received kickbacks from one of his company's suppliers. SEC v. Kalvex, Inc., 425 F.Supp. 310 (S.D.N.Y. 1975). Judge Owens did not mention Kalvex in the later decision. Kalvex may have been incorrectly decided because it does not appear that the proxy statement caused or constituted a link in the accomplishment of the kickback scheme. Judge Haight however, attempted to reconcile Kalvex with Levy, holding that there was transaction causation when nominees for election did not disclose that they had been stealing from their corporation, which was the situation in Kalvex, but not in Levy.

He said:

"While the indictment charges certain defendants with manipulation of TDA common stock, and the acquisition and resale of certain shares of TDA stock in a manner that could certainly be regarded as fraudulent, the corporation's assets were not looted or depleted in any way. Purchasers of TDA common stock may have been defrauded; sellers of previously restricted TDA stock may have

been defrauded; these transactions may very well cast certain of the defendants in an unflattering light; but the facts as pleaded by the Government do not give rise to a potential violation of Section 14(a) in respect of the TDA proxy solicitation." (A95-96)*

There is simply no charge in count one of the indictment that the defendants stole anything from TDA or used the corporation for their personal gain. No form of hidden director's compensation is involved in the case at bar and Kelvex, whether or not correctly decided, is inapposite.

The Government, in its motion for reargument below and on this appeal, contends that defendants Fields and Friedman allegedly caused a company, in which TDA owned a minority interest (Westcalind), to pay a fee, part of which was paid back to those defendants, and that that transaction should have been disclosed in the proxy statement. In its opinion denying the motion for reargument, the District Court held that Westcalind was not consolidated for financial reporting purposes with TDA, that TDA carried its Westcalind investment as an asset and that

"the kickback could have influenced the TDA solicitation only if the theft was of such magnitude that it caused Westcalind's financial condition to be substantially overstated, thereby causing its stock to be overvalued, thereby causing TDA's 'assets' figure in the

*On reargument the District Court further explained that "the proxy solicitation regulations do not require disclosure of a directorship candidate's speculations, if those activities were not practiced upon the corporation to whose board he is seeking election." (A.123)

annual report to be inflated, thereby causing TDA's shareholders to be misled as to the condition of their company, under the leadership of the individuals standing for election. However, this kind of potential impact is too remote and speculative a ground on which to predicate a criminal violation of the proxy solicitation regulations because the required 'transaction causation' is absent." (A.124)

The Government argues, for the first time in this appeal, that the defendants' actions in April and May, 1971 as set forth in Count One of the indictment constitute a transaction within Section 16(b) of the Exchange Act, the liability for which defendants were required to set forth in the proxy statement. There is no 16(b) charge in the indictment and the Government apparently did not think enough of this argument to make it below. We could find no case, in fact, where a 16(b) transaction was made the subject of a criminal charge. Nor does there ever appear to have been a criminal case charging a proxy rule violation for failure to disclose a 16(b) transaction.* In any event, just as it cannot be said that the proxy solicitation in November, 1971

*The Government's attempt to expand the scope of Section 14 in a criminal case is incongruous and contrary to the consistent trend of the Supreme Court in narrowing the reach of the federal securities laws, including the proxy rules. See, e.g., TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438 (1976) (\$14[a]); Santa Fe Industries v. Green, 97 S.Ct. 1292 (1977) (\$10[b]); Piper v. Chris-Craft Industries, Inc., 430 U.S. 1 (1977) (\$14[e], 10[b]); Foremost-McKesson, Inc. v. Provident Securities Co., 423 U.S. 232 (1976) (\$16[b]); Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975) (\$10[b]).

caused the TDA shareholders in April and May, 1971 to sell their shares to defendants, or that it caused the market manipulation which occurred in November, it cannot be said that the alleged 16(b) transaction which occurred in April and May, 1971 was caused by the proxy statement. That proxy could not have been "a link in the accomplishment" of the earlier 16(b) transaction. Lewis v. Elam, (at 91, 555).

Moreover, it has generally been held that disclosure of an event is not required until a claim has been made or a litigation commenced with respect to the non-disclosed item. As noted in Note, Disclosure of Payments to Foreign Government Officials Under the Securities Acts, 89 Harv. L. Rev. 1849 at 1857, this is the "SEC's litigation rule", a "traditional requirement" that there must be disclosure only of "pending litigation and past criminal and administrative sanctions against officers, directors and board nominees.":

"The tendency of the courts and Commission in the past to insist on disclosure of improper conduct only if it has been attacked in judicial or administrative proceedings appears to reflect a recognition of the difficulty of formulating clear standards to identify information casting doubt on management's integrity." Id. at page 1858.

See Chris-Craft Industries, Inc. v. Independent Stockholders Committee, 354 F.Supp. 895 (D. Del. 1973) where the court

rejected a claim that a proxy statement was misleading because it failed to reveal the "unsavory" background of defendant Cohen, stating as its reasons that "there were never any charges filed against Cohen nor even an investigation made." Id. at 914. The same can be said of the 16(b) matter here, for as of the time the proxy statement was distributed in November, 1971, there was no claim, charge or even an investigation of a 16(b) transaction. See also Sonesta Int'l Hotels Corp. v. Wellington Associates, 483 F.2d 247 (2d Cir. 1973).*

In summary, there can be no proxy rule violation as a matter of law because the proxy did not cause, nor was it a link in, the alleged misconduct of defendants which had occurred before the proxy was distributed, whether that misconduct be termed a securities fraud or a short-swing trade within the meaning of Section 16(b).

*It is a specific requirement of many SEC forms that there must be disclosure only of pending criminal proceedings or convictions or of an existing order subjecting the director to specific types of injunctions. See Form S-1, Item 16(3), Form 10, Item 6(e), Form 10-k, Item 15(c).

CONCLUSION

The District Court's orders should be affirmed, in all respects.

DATED: New York, New York
October 19, 1977.

Respectfully submitted,

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SS.:
COUNTY OF NEW YORK)

IRIS L. WASHINGTON, being sworn says: I am not a party to the action, am over 18 years of age and reside in Orange, New Jersey.

On October 21, 1977 I served two true copies of the annexed Brief of Defendant-Appellee Peter S. Davis by mailing the same in a sealed envelope, with postage pre-paid thereon, in a post-office or official depository of the U.S. Postal Service within the State of New York, addressed to the last known address of the addressees as indicated below:

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IRIS L. WASHINGTON

Sworn to before me this
24ST day of October, 1977.

Gary H. Greenberg
Notary Public

GARY K. GREENBERG
Notary Public, State of New York
Qualified in New York County
Commission Expires March 30, 1979

STATE OF NEW YORK)

SS. :

COUNTY OF NEW YORK)

CLIFTON SMITH, being sworn says: I am not

On October 21, 1977, I personally served two

Robert B. Fiske, Jr.
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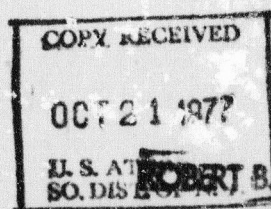
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CLIFTON SMITH

Sworn to before me this
21 day of October, 1977.

Notary Public

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Commission Expires March 30, 197...



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U.S. AT SO. DIST. COURT ROBERT B. FISKE JR.